NO. 2575

IN THE

United States Circuit Court of Appeals For the Ninth Circuit

GEO. M. HEALY, as Trustee in Bankruptcy of the Estate and Effects of H. J. Martin,
Plaintiff-Appellant.

v.

W. H. WEHRUNG,
Defendant-Appellee.

BRIEF OF APPELLANT.

Upon Appeal from the District Court of the United States for the District of Oregon.

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BOYER PRINTING COMPANY, PORTLAND, OREGON

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STATEMENT OF FACTS.

This controversy arose in connection with the estate of H. J. Martin, bankrupt, under administration in the District Court of the United States for the District of Oregon.

On the 4th day of March, 1913, Martin was heavily involved and utterly insolvent. His assets consisted of a stock of goods in a drug store, a postal card shop, his home (claimed as exempt), 46½ acres of land in Washington County, Oregon, and some accounts of trifling value. The land was valued at approximately $7,000, and constituted the principal asset.

Martin owed at this time to mercantile creditors about $70,000, all of which was past due. He also owed W. H. Wehrung, the defendant herein, and the mother of the defendant, and the Hillsboro National Bank of which the defendant was President, approximately $5571.05. Martin was represented by Attorney Alex. Sweek, and at the time mentioned was offering through this attorney to his creditors, a settlement of 20 cents on the dollar.

The defendant Wehrung, in order to collect the claims represented by him, procured a purchaser of Martin's property in Washington County in the person of one Douty. Martin did not know Douty and had no conversation with him until the time came for signing the deed. In fact, at the first hearing in bankruptcy Martin did not even know who had purchased the land, the arrangements having all been made by Mr. Sweek, Martin's attorney, and Mr. Wehrung. Wehrung employed his own attorney to give Mr. Douty an opinion as to the title and Douty employed no one to examine the abstract, but depended upon the opinion of Wehrung's lawyer.

The transaction was consummated at the office of W. M. Davis, in the suite occupied by Davis and Alex. Sweek, Martin's attorney. The entire purchase price was turned over to Wehrung, who cancelled the Martin notes. The amount of the purchase price, by what Mr. Wehrung says was a coincidence, equaled exactly the amount of the notes, interest, etc. Mr. Sweek, Martin's attorney, was the endorser on one of these notes.

Three weeks later Martin was adjudicated a bankrupt. The estate carefully administered paid the creditors ten cents on the dollar.

This suit was instituted by the Trustee under Section 60b of the Bankruptcy Act, providing:

> "If the bankrupt shall have given a preference and the person receiving it, or to be benefited thereby, or his agent acting therein, shall have had reasonable cause to believe that it was intended thereby to give a preference, it shall be voidable by the trustee, and he may recover the property or its value from such person. And, for the purpose of such recovery, any court of bankruptcy as hereinbefore defined, and any State court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction."

The U. S. District Court held that the evidence adduced by the Trustee was insufficient to bring the case within the provisions of that section, and the appeal is taken from the decree dismissing the suit, the only question therefore being the one stated in the single

ASSIGNMENT OF ERROR.

That the United States District Court for the District of Oregon erred in failing to enter a decree herein in accordance with the prayer of the complaint and in dismissing the plaintiff's Bill of Complaint, the basis of this contention being that the testimony required a decree in favor of the plaintiff in that the evidence adduced demonstrated that defendant within four months prior to the adjudication in bankruptcy of H. J. Martin, received a preferential payment from said bankrupt, and that said defendant had, at said time, reasonable cause to believe that the bankrupt was insolvent and that the defendant would thereby and did receive a greater percentage than other creditors of the same class.

ARGUMENT.

In determining whether or not the transfer involved in this suit constitutes a preference within the purview of the Bankruptcy Act, the spirit and purpose of that Act must be the primary consideration. It was passed and is retained upon the statute books not merely to furnish a refuge for insolvent debtors, but as pointed out by the Supreme Court of the United States in the case of Toof v. Martin, 13 Wall. 40, 20 Law Ed. p. 78:

> "The act of Congress was designed to secure an equal distribution of the property of an insolvent debtor among his creditors, and any transfer made with a view to secure the property, or any part of it, to one, and thus prevent such equal distribution, is a transfer in fraud of the act."

The Supreme Court uses the expression "in fraud of the Act," advisedly. "Fraud" in a moral sense is not a necessary element in an inhibited preference. This is clearly pointed out by the Supreme Court of North Carolina, in the case of Wilson v. Taylor, 70 S. E. Rep. 286, 289:

> "It is not necessary in order to invalidate the preference, that there should have been any moral or actual fraud. It is simply a constructive fraud, arising by law upon the existence of certain facts and forbidden by it. There is nothing dishonest or illegal in a creditor, obtaining payment of a debt due him by a failing or embarrassed debtor, nor in his attempting by proper and ordinary effort, to secure an honest debt, but such an act may otherwise become constructively fraudulent and illegal by reason of the filing of a petition and an adjudication in bankruptcy. It is voidable by the trustee of the bankrupt's estate because the law says it shall be so, regardless of the moral quality of the act, or intent or motive of the debtor, however honest it may have been. The law considers only the ultimate effect of such act as being inconsistent with the very purpose and policy of the bankrupt act, which is the equal and equitable distribution of the bankrupt's estate among his creditors, subject only to the preferences or priorities therein allowed."

In the study of the case at bar we have read many decisions in controversies over real or alleged preferences, but if there is any instance in the books more flagrantly violative of the spirit of the Bankruptcy Act than that here discussed it has escaped our attention. We ask the Court to consider these bald facts which constitute the skeleton of the case and *as to which there is no dispute*:

A debtor is grossly insolvent, offering a settlement of twenty cents on the dollar to his creditors. The debtor's lawyer is responsible on some of his paper held by a creditor representing $5,875. On the advice of that lawyer, the debtor, on the eve of bankruptcy, transfers his princi-

pal asset, his unexempt real estate, to a hurry-up purchaser, produced by that creditor, the creditor furnishing and paying his own lawyer for services in connection with the title in order to save the time of examining the abstract.

The transaction is consummated in the suite occupied by the debtor's lawyer. The selling price by a remarkable coincidence exactly equals the indebtedness to the creditor—$5,875. The debtor a few weeks later does not even know who purchased the property. The creditor thus secures one hundred cents on the dollar, and all the other creditors ten cents.

If the bankruptcy law is anything other than a farce and a pretense insofar as the preservation of parity between creditors is concerned, these facts constitute, without the production of any additional circumstances, intrinsic evidence that a preference has occurred which should be nullified. Before taking up the testimony in greater detail, we ask consideration of the construction placed by the Courts on the section of the Bankruptcy Act in question, and the nature of the proof required thereunder.

It may be remarked that four elements are necessary to constitute a voidable preference:

First, the debtor must have been insolvent at the time of the transaction;

Second, the transaction must have taken place within four months before bankruptcy proceedings.

Third, the effect of the transfer must have been to give the preference creditor a greater percentage on his claim than that accruing to other creditors;

Fourth, there must have existed at the time of the transfer reasonable cause for the creditor to believe that it would result in a preference.

The presence of the first, second and third elements are not disputed. The Bankruptcy Schedules showed an indebtedness of about $70,000, excluding the $5,875, represented by Wehrung. The assets under careful administration yielded a gross sum of less than $12,000. Much of this was consumed in paying priority claims and the general creditors received ten cents on the dollar.

We are concerned therefore only with the fourth element. With regard to the proper interpretation of this particular and important phase we ask the attention of the Court to

SOME ILLUSTRATIVE CASES.

The leading and most oft-cited cases in this connection are two, which construe similar sections of the former Bankruptcy Act. The first is Toof v. Martin, 13 Wall. 40, 20 L. Ed. p. 78, wherein Mr. Justice Field said:

> * * * * *
>
> "The statute, to defeat the conveyances, does not require that the creditors should have had absolute knowledge on the point, nor even that they should in fact, have had any belief on the subject. It only requires that they should have had reasonable cause to believe that such was the fact. And reasonable cause they must be considered to have had when such a state of facts was brought to their notice in respect to the affairs and pecuniary condition of the bankrupts as would have led prudent business men to the conclusion that they could

> not meet their obligations as they matured in the ordinary course of business."

The other is Wager v. Hall, 16 Wall. 584, 21 L. Ed. 506, wherein the Supreme Court of the United States fully and clearly laid down the connotations of the language used in the Bankruptcy Act:

> "Nothing remains therefore to be reexamined, except the issue whether the respondents had reasonable cause to believe that the mortgagor was insolvent and that the conveyance was made in fraud of the provisions of the bankrupt act. Proof that the respondents had actual knowledge that the mortgagor was insolvent at that time is not required to support the prayer for relief, but the allegation in that behalf is sustained if it appears that they had reasonable cause for such belief, as that is the language of the bankrupt act. *Actual knowledge of the alleged fact is not made the criterion of proof in such an issue, nor is it necessary that it should appear that the respondents actually believe that the mortgagor was insolvent; but the true inquiry is, whether they, as business men, acting with ordinary prudence, sagacity and discretion, had reasonable cause to believ that the debtor was invsolvent, in view of all the facts and circumstances known to them at the time the conveyance was made.* Coburn v. Proctor, 15 Gray. 38. Unless the debtor was in fact insolvent it cannot be held that such a grantee had reasonable cause to believe the allegation; but if it appears that the debtor was in fact insolvent as alleged, and that the means of knowledge were at hand, and that such facts and circumstances were known to the grantee as were clearly sufficient to put a

person of ordinary prudence and discretion upon inquiry, it is well settled that it would be his duty to make all such reasonable inquiries to ascertain the true state of the case. * * * * * Creditors have reasonable cause to believe that a debtor, who is a trader, is insolvent when such a state of facts is brought to their notice respecting the affairs and pecuniary condition of the debtor as would lead a prudent business man to the conclusion that he is unable to meet his obligations as they mature in the ordinary course of business. Toof v. Martin, 13 Wall, 40, 20 L. ed. 481. *All experience shows that proof of fraudulent acts, between debtor and creditor, is not generally to be expected, and it is for that reason, among others, that the law allows in such controversies, a resort to circumstances as the means of ascertaining the truth, and the rule of evidence is well settled that circumstances altogether inconclusive, if separately considered, may, by their number and joint operation, especially when corroborated by moral coincidence, be sufficient to constitute conclusive proof, which is a rule clearly applicable to the facts and circumstances disclosed in this record."* (Italics ours.)

All of the later cases are but variations, modifications, and amplifications of this doctrine. We mention only a few.

One of the cases most frequently cited is the well considered decision in Coder v. McPherson, 152 Fed. 951; participated in by Circuit Judges Sanborn, Hook and Adams, in which a decision of the District Court that a mortgage to a bank executed shortly before bankruptcy of the mortgagor, did not constitute a preference, was reversed. The Court referred to the known difficulty of converting real estate into money to pay debts, as an obvious "danger signal," and added with reference thereto:

> * * * "which could not have failed to incite a creditor of ordinary prudence to searchingly investigate the solvency of the debtor.
>
> *Notice of facts which would incite a man of ordinary prudence to inquiry under similar circumstances is notice of all the facts which a reasonably diligent inquiry would disclose.*
>
> The inevitable effect of these incumbrances was to deprive the unsecured creditors of every means of collecting their debts; for these mortgages withdrew from attachment and execution substantially all the debtor's unexempt property. The legal presumption is that parties intend the inevitable effect of their acts, and, in view of all these facts, the conclusion is irresistibly borne in upon our minds that the court below committed a serious mistake of fact in the examination of the case, and that the bank on July 13, 1904, when it took these mortgages, had reasonable cause to believe that it was intended thereby to give it a preference over other creditors of the same class." (Italics ours.)

For a discussion of the subject which is thorough and we believe unexcelled in clarity and force of logic we ask the Court to read the opinion in Ogden v. Reddish, 200 Fed. 977. To quote apposite portions would require our copying here practically the entire opinion.

We also invite the court's attention to the following as particularly well considered and apt decisions:

In re Hines, 144 Fed. 545;
In re C. J. McDonald & Sons, 178 Fed. 487;
Stern v. Paper, 183 Fed. 228;
Alderdice v. Bank. Fed. case No. 154;
In re Va. Hardwood & Mfg. Co., 139 Fed. 312;
McGurr v. Grocery Co., 192 Fed. 55;
Bardes v. Bank (Iowa) 98 N. E. 284;
Whitwell v. Wright, 115 N. Y. Supp. 48;
Heyman v. Bank, 216 Fed. 685;

EAR MARKS OF PREFERENCE IN THE INSTANT CASE.

It results from these cases that a business man, ordinarily alert, keen and vigilant cannot appropriate the bulk of an insolvent estate on the plea that he should be absolved from accounting to the other creditors, because he deliberately shut his eyes, or refrained from exercising his faculties; he cannot be heard to say that a transaction of most unusual character the effect of which was to enable him to collect 100 cents on the dollar, while other creditors got ten cents, hurried through obviously for that purpose, did not appeal to him as out of the ordinary. The Supreme Court of the United States pointed out in the case of Wager v. Hall, supra, that it will not often be possible to procure admissions of knowledge that a preference is being secured or even direct evidence thereof, and that resort must be had ordinarily to the *circumstances* of the particular case. In the light of that familiar fact we call the court's attention to some of the eloquent circumstances of this transaction, which render it palpably a gross violation of the equitable principles of the Bankruptcy Act.

(a) LONG PERIOD OF INDEBTEDNESS.

The indebtedness from Martin to Wehrung and those represented by Wehrung, was of long standing. It dates back certainly as early as January or May, 1909, and some years prior to that, although Wehrung's testimony in this particular was not clear. Wehrung admitted that he had made frequent unsuccessful efforts to collect (Transcript, p. 88), and this fact in itself makes it clear that Wehrung knew Martin was unable in the ordinary course of his business to liquidate the indebtedness. The National Bank examiner had complained as to the note due the Hillsboro National Bank. The Court surely has the right to exercise the acumen which it is fair to attribute to men of affairs, and we urge the fact that neither the Bank at Hillsboro, nor a banker in that place is anxious to retain an unsecured loan to a person at Portland, who is not one of its depositors and who is not even a personal friend of the banker (Transcript, p. 87). It taxes credulity that a shrewd bank president like Wehrung felt at ease with regard to a long standing indebtedness of this character.

It is true Defendant Wehrung testified that although he could place his money on mortgages at the same rate of interest he was glad to have this unsecured loan. In fact it was such a splendid investment, according to Wehrung, that although he was not a friend of Martin, he would gladly have loaned Martin more money at the time when he made this surprising collection. (Transcript of Record, p. 87.) The 'note of exaggeration' in similar "sweeping statements" was referred to as affecting the value of the creditors' testimony in Ogden v. Reddish, 200 Fed. 977.

This curious testimony of Wehrung's is to be taken in connection with the fact that some time before, Wehrung had had to agree to postpone his claim in order that Martin might procure an extension from his creditors and avoid being closed up, and that Wehrung knew Martin for some time previous had been and was buying his business necessities for cash and without credit. (Transcript of Record, p. 81.) The statement volunteered by Wehrung that he would gladly have increased the loan is so preposterous as to discredit his other evidence.

We do not believe it possible to read in such testimony anything other than a reckless intent to disclaim every attribute of common sense in an effort to retain the preference.

(b) MANNER OF PAYMENT.

Martin's indebtedness was all past due. He was compelled to buy locally for cash. Any unusual method out of the ordinary course of business by which such a merchant raises a large amount of cash is sufficient to attract an alert creditor's attention.

Now, Martin did not sell this property. His connection with the sale was limited to the perfunctory signing of his name. Shortly after the transaction, involving as it did, his principal asset he *did not even know who was the purchaser.* (Transcript of Record, p. 63.)

In fact Martin did not know how much he owed Wehrung (Transcript, pp. 62-63). *It was all attended to by his attorney, Mr. Sweek, who was liable on one of the notes, and by Mr. Wehrung.* (Transcript, p. 63.) Mr. Sweek advised Martin that *there was no legal obstacle to the scheme.* (Transcript, p. 63.) Mr. Sweek, as endorser, had, of course, a *personal interest* in seeing these notes paid before the bankruptcy proceedings. At that very time *Mr. Sweek, acting for Martin, was offering other creditors twenty cents on the dollar!*

However, suppose we eliminate for the moment the unusual feature of the creditor finding a purchaser, and attending to the sale without the participation of the owner of the property. Surely it must be conceded that in the ordinary course of business the purchaser will employ his own attorney to examine the abstract and pass upon the other papers. Surely it is not the ordinary practice for a *creditor* who is not worried about an indebtedness and who, although not a personal friend, would in fact gladly at the time have loaned more money, to go to the expense of employing his own lawyer to render an opinion to the purchaser upon the title. That is what Mr. Wehrung did.

If those facts do not demonstrate that Wehrung knew the situation was a desperate one requiring quick action, without being particular about a little expense, then all human experience counts for naught, and any trick or scheme may be worked with impunity so long as the creditor is willing to mount the witness stand and unblushingly testify that although he had made many efforts to collect a four or five year old account, and in the end had secured a purchaser for his debtor's property, and furnished a lawyer at his own expense to the purchaser, he was not in the slightest degree exercised about the account and in fact would gladly have made a larger loan. This same witness is frank enough to admit that it is not his custom to make presents or to abate a dollar of his demand. (Transcript, p. 50.) We omit laying stress upon the admission of Douty, the purchaser (a most unwilling witness), that *Wehrung told him that Martin was in bad shape, and badly in need of money.* (Transcript, pp. 33-34.) We are using circumstances which are *conceded,* and even if the attention is limited to conceded facts, we ask the Court whether a creditor not exercised about the insolvency of his debtor, ordinarily pursues a course like that of Wehrung, or whether Wehrung's method of handling this situation characterizes one who is seizing the single chance to get out whole and leave the other creditors "holding the bag?"

The Court in Heyman v. Bank, 216 Fed. 685, makes an observation which experience surely justifies:

> *"The unusual in business, as well as in other transactions, challenges the attention, and the failure of the bank to prosecute the prescribed inquiry cannot be permitted to inure to its benefit to the prejudice of the depositor's other creditors of the same class."*

And so in re: C. J. McDonald & Sons, 178 Fed. 487:

> *"The facts are so persuasive that they would have given reasonable ground for suspicion to persons far less astute and less accustomed to the ways of business in gen-*

eral than was the president of this bank. The unusual nature of the transaction, in connection with all the circumstances, raises such a presumption that it can only be overcome by proof on the part of the preferred creditor that he took the proper steps to find out the pecuniary condition of the debtor.

(c) WEHRUNG'S PARTICIPATION IN MARTIN'S REQUEST FOR EXTENSION.

An important admission of Wehrung's is with reference to the fact that when some time prior to the transaction complained of, Martin had found it necessary to apply to his creditors for an extension, Wehrung had been compelled to agree to postpone this particular claim. Surely this would put an alert banker upon inquiry. It should also cause an honest banker to inquire before grabbing the principal asset of the debtor, whether or not these claims had been paid, and this, Mr. Wehrung carefully refrained from doing (Transcript of Record, pp. 82-83). Without any such inquiry as to whether these claims had been paid or not (and as a matter of fact they had not been paid), Wehrung employs this scheme to get out whole. Can it be denied that that agreement was what Judge Sanborn in Coder v. McPherson called a "danger signal"? Can any man of Wehrung's intelligence and in Wehrung's position fairly claim that he was not anxious about the indebtedness under such circumstances?

(d) COINCIDENCE IN AMOUNT OF SELLING PRICE AND AMOUNT OF CLAIM.

Wehrung is a shrewd banker. Needless to say when he has a solvent debtor who is paying a note he collects principal and interest and does not donate anything He admits this much.

We were struck by the remarkable coincidence in connection with the amount of the selling price of the property — $5875.00—and the amount of Wehrung's claim. Wehrung asserts that figuring the amount of principal and interest due on the notes on March 4, 1913, it totaled $5875, the difference not exceeding 35 cents.

We have tried to figure it in many ways, but we have found no method by which the amount of principal and correct figures as to interest, will come within $20 of the $5875. It is manifest that the interest figures are forced.

Taking it at its face value, Wehrung's admission that he would not donate anything, it is difficult to conceive of stronger evidence that Wehrung was taking what he could get and wisely, from his standpoint, refraining from collecting a few dollars' difference when he knew if he did not grab what was in sight quickly, he might, like other creditors, have to take ten or fifteen cents on the dollar.

(e) THE ACTUAL SITUATION.

Wehrung admits knowledge (at the time of obtaining the preference) of Martin's indebtedness to the extent of $50,000, aside from $8000 or $9000 to the United States National Bank. He was frequently in Martin's drug store. He knew that there was no cash on hand or in bank, and that Martin had had to ask extensions, etc., and a glance at the shelves of that drug store would suffice to demonstrate to him or any ordinary business man, Martin's insolvency. The careful liquidation of the assets in bankruptcy netted a dividend of 10 cents on the dollar to creditors. So glaring an hiatus between bona fide assets and liabilities is a fact and circumstance to be considered. The Circuit Court of Appeals for the Sixth Circuit declared that one way to test the belief that should be imputed to a creditor is to ascertain what belief the facts actually warrant. (Carey v. Donohue, 209 Fed. 328.)

Martin's statement of Feb. 1, 1913.

The bulwark of the defense is the claim that on Feb. 1, 1913, Martin had rendered to Wehrung a statement showing that he was solvent. Apparently in the opinion of the trial judge, this testimony was sufficient to justify Wehrung in avoiding other avenues of inquiry, scrupulously refraining from any investigation and even failing to analyze the statement.

We quote again from the lucid opinion of the Court in Heyman v. Bank, 216 Fed. 685; 693:

> "True, the bankrupt was asked, "where he stood," and he replied, according to Mr. Castens, that "he was solvent." This is not an unusual response by a failing debtor. None more hopeful than an honest debtor of his ability to pull through a financial crisis; and it is not necessarily a discrediting factor that he alone believes his assets are sufficient to pay all obligations. *Such assertions, however, are not always to be taken at their face value and they seldom are by experienced business men. Actions speak louder than words, and their voice is not to be stilled by mere asservations.* The inquirer is not to rest content with mere assertions by the debtor that he is solvent, and perfunctorily making inquiries is no better than making none. His answers should be

> tested in the ordinary way to elicit the truth and the inquiry pressed with reasonable intrusiveness. In re John J. Coffey, 19 Am. B. Rep. 149; McGirr v. Humphreys Grocery Co. (D. C.), 192 Fed. 55, 26 Am. Bank Rep. 518. If he fails to do this he is chargeable with knowledge of the facts which such inquiry and testing would have disclosed, and, if such facts would have given him reasonable cause to believe that a preference would result from the transaction, such transaction will be voidable at the suit of the trustee. A bank cashier, than whom, because of exceptional opportunities and facilities to ascertain the financial standing of its customers, none is more competent to weigh assertions made by a customer, is not likely to be misled by such statements; and when, as in this case, he is possessed of the facts, which in their lesser effect cast doubt on its accuracy, his duty is to prosecute his inquiries further and not to halt them by the fear that an unsatisfactory disclosure would result."

See to the same effect:

> McGirr v. Humphrey, 192 Fed. 55.
> Stern v. Paper, 183 Fed. 228.

A concern, for instance, like the Clarke-Woodward Drug Company, located in Portland and close at hand, has a claim of $7,000 against Martin. It had tried, according to the testimony, strenuously, for a year or more, through attorneys and otherwise, to collect all or part of this sum from Martin, without success, and Martin had bought his immediate necessities for cash during that period. Along comes Mr. Wehrung and secures the principal asset on the eve of bankruptcy and in answer to the charge that he has violated the spirit of the Bankruptcy Act, in so doing Mr. Wehrung is permitted to shield himself behind a statement secured by him from Martin, a month or more previously. That statement is, of course, admissible in evidence, but we submit that the trial court paid it an excess of deference in comparison with the treatment accorded the striking circumstances attending the collection.

With all deference to the trial judge in the case, for whose ability we have the most unbounded respect, we submit that no banker or business man, and that is the standard by which Wehrung is to be judged, would for a moment consider Martin solvent, even on the grossly false statement of Feb. 1, 1913.

The trial court indicated its belief (Transcript, p. 77) that a banker like Wehrung would have the right to take such a statement and rely upon it without making any inquiry or investigation, and consider it at its face value apparently without question. It is also clear from the interpolations of the trial judge that while he correctly believed that the value of Martin's assets was to be considered in the light of Martin's business as a going concern, he also seemed to consider that this meant the original cost price, etc., of old merchandise and fixtures, and the face value of accounts.

We are, of course, far from contending that the values are to be figured on a wreckage basis. We do contend, however, that they are to be computed not on original cost, but on the fair market value. As pointed out by the Court in Stern v. Paper, 183 Fed. 228:

> "Fair valuation within the meaning of subdivision 15 of section 1 of the Bankrupt Act, means a value that can be made

> promptly effective by the owner of the property to pay his debts. That is the language of this liberal statute. It ought not to be enlarged. Such a value excludes, on the one hand, the sacrifice price that would result from an execution or foreclosure sale, and, on the other hand, the retail price that could be realized in the slow process of trade. This latter value should be excluded because it could only be gained by large expense and the many risks of a mercantile venture. "Fair valuation" means such a price as a capable and diligent business man could presently obtain for the property after conferring with those accustomed to buy such property. Such a value will depend upon many circumstances, such as the age and condition of the stock, the season of the year, and the state of trade."

Here is a statement showing $50,000 of liabilities, all of which were past due, and *not a dollar of cash on hand or in bank with which to pay them.* (In addition to that there was apparently some eight or nine thousand dollars due the U. S. National Bank not computed, but as to which Mr. Wehrung was advised.)

There was no money available and it is hardly fair to figure values on the basis of original cost or over-the-counter business. The creditors must be paid and the assets converted into money. What were the assets out of which these creditors were to be paid?

An old postal card and drug stock. Any business man, even though not a banker, knows that the best of stocks would not have a market value exceeding 75 per cent of the original cost. And in the case of an old drug and postal card stock 50 per cent would be an extreme allowance, and Wehrung well understood that. The question was whether or not Martin was solvent, and there is only one way of determining that, and that is, to consider whether or not his assets at a fair market value would realize sufficient to liquidate his liabilities, and we assert that no man in Wehrung's position would be guilty of the folly of believing that a fair market value of that drug and postal card stock was 100 per cent of what it had cost some indefinite time previously.

There were also fixtures listed at about $7,000, original cost. Wehrung had the *audacity* to testify that fixtures often bring (outside of goodwill or any other consideration) more than the original cost. *Surely a Judge is not required to silence every bit of common sense and experience and swallow statements such as that.* If there has ever been in the history of commercial transactions any fixtures which have been used for a long time in a store, of which the fair market value is the original cost, the history of the liquidation of assets has been silent on the subject. It is rare that 25 cents on the dollar can be realized. Certainly 50 cents on the dollar, or $3500, for the fixtures would be a liberal estimate.

(Mr. Wehrung made no inquiry as to whether these fixtures were paid for, and disclaims knowledge of the fact that Martin in reality had no title whatsoever to them, same having been purchased under a conditional bill of sale.)

Again, we have the old accounts. In considering the fair market value of these, Mr. Wehrung estimated it at 90 per cent. This allows 10 per cent for losses and cost of collection! If any concern which has been in business a long number of years and has a lot of old accounts can get 90 cents on the dollar net for them, it will certainly be a most gratifying experience. However, figuring the accounts at 90 cents on the dollar, the stock at 75 cents and the fixtures at 50 cents, we would have a shrinkage of $14,618.12. In the light of such an analysis which any ordinarily prudent man would make of the statement, false as it was, Martin was insolvent. It will be noted that we are making no computation of the *expense of liquidation* which would have to be considered in determining the fair market value of assets of this character of which it is so notoriously difficult to effect an advantageous sale.

We submit that the trial judge was wrong in assuming that a creditor can take any sort of a statement at its face value. Such a view would permit a facile method of rendering a preference inviolable. As said by Black in his work on Bankruptcy, Section 599, referring to the duty of a creditor to prosecute a reasonably diligent inquiry to ascertain the truth:

> "As to the kind of investigation to be conducted by a creditor thus 'put on inquiry' his duty is not discharged by inquiry addressed to the debtor alone, at least if any better or more reliable sources of information are open to him."

The trial court (Transcript, p. 77) apparently differentiated between a loan about to be made on the faith of such assets and a loan already made. We are unable to see any basis for this distinction where the inquiry is whether or not there was reasonable cause to believe a debtor insolvent. If Wehrung had been about to make a loan he would consider the question of solvency and in so doing would consider the fair market value of the fixtures, etc., and not the original cost.

The trial judge believed (Transcript, p. 77) that the question was whether Wehrung did or did not have the right to assume that Martin was solvent on the basis of that statement *"and nothing* else." But there was *"something else."* That something was that Wehrung had been trying for some time to collect his claim and that he had been compelled to consent to the extension and even to postponing his claims to that of Eastern creditors, and there was also the curious chain of circumstances connected with the final method of collection.

* * * * *

In spite of the fact that in considering the existence of reasonable cause to believe that a preference is taking place, all the decisions to which we have had access have pointed out the important bearing of unusual circumstances, the trial court in this case apparently considered it beside the mark as to whether or not the purchaser, Douty, had his title examined, or accepted as a substitute, an opinion procured by Wehrung at his own expense from his own attorney. (Transcript, p. 40.)

We have already cited authorities with regard to the significance of "unusual" circumstances. We beg to quote somewhat liberally, however, from the well-reasoned case of Stern v. Paper, 183 Fed. 228:

> "We must also consider in passing upon this branch of the case, the transaction which is charged as a preference. *It was extraordinary in its character.* The defendants themselves are merchants, and must have known that other creditors would not stand by and permit a

large part of Naftalin's stock to be appropriated to a single creditor without immediately pressing their claims to judgment and execution.

* * * * *

All these facts suggest strongly that both the defendants and the bank saw that the end of Naftalin's mercantile career was at hand, and called for the payment of the note in order that the defendants might have an opportunity to protect themselves before the crash came. About two weeks after the sale to defendants, a Mr. Tilly, who had been their attorney, was employed by the bankrupt to visit his creditors and try to make a settlement with them on the basis of 20 cents on the dollar. Forty days after the sale Naftalin was adjudged a bankrupt.

Do the circumstances and evidence above narrated show that the defendants had reasonable cause to believe that the transfer was intended as a preference? The authorities tell us that section 60 of the bankruptcy act does not, on the one hand, require actual knowledge or actual belief of an intent to prefer (in re Eggert, 102 Fed. 735, 43 C. C. A. 1; in re Virginia Hardwood Mfg. Co. (D. C.) 139 Fed. 209) and, on the other hand, that mere fear or suspicion of a preference will not invalidate a transfer (Powell v. Gate City Bank, 178 Fed. 609, 102 C. C. A. 55). Thus between actual knowledge and actual belief, on the one side, and fear and suspicion, on the other, lies the 'reasonable cause to believe' mentioned in the section. This classification however, is not as helpful in the decision of a concrete case as it appears. *Fear and suspicion of insolvency, if they be strong enough, become belief,* and the difficulty with the classification is that there are no criteria by which it can be said that one set of facts ought to engender fear or suspicion only, while another set of facts furnish reasonable cause of belief. It is impossible to group the ever-changing facts of business life into hard and fast categories, and say that one category produces fear, another suspicion, and another belief. * * * 'Reasonable cause to believe,' under section 60 of the bankruptcy act, covers substantially the same field as 'notice' in determining whether a person is a bona fide purchaser of property. Hence, under this statute, 'notice of facts which would incite a person of reasonable prudence to an inquiry under similar circumstances is notice of all the facts which a reasonably diligent inquiry would develop.' Coder v. McPherson, 152 Fed. 951, 82 C. C. A. 99. But if a party has knowledge of facts which cause him to fear or suspect that a transaction into which he is entering will work a preference, that knowledge as a rule will at least be sufficient to put him upon an inquiry which if prosecuted would disclose the real character of the transaction. It *follows, therefore, in my judgment, that the doctrine that fear, or suspicion of a preference is not sufficient to invalidate a transfer must have a restricted application under our present bankruptcy law.*

What constitutes 'reasonable cause to believe,' under this section, is a pure question of fact, and each case is best disposed of by an independent consideration of its own facts. The attempt to apply the doc-

> trine of authority to such questions simply results in exalting a few facts that have been emphasized in the first decision so as to bring the second case within its scope, and overlooking the other facts which ought possibly to determine the second, case. What the statute requires is that the facts and circumstances known to the purchaser shall be ascertained, and then the question answered whether those facts and circumstances would have caused an intelligent business man to believe that a preference was intended, or would have put such a man upon an inquiry that would have discovered the true character of the transaction." (Italics ours.)

To our mind, with all deference, it seems quite significant that a creditor in order to collect his debt, should become a real estate agent and even employ his own lawyer to examine and pass upon the title, especially in the light of that creditor's testimony that he was not worried about the debt, and in fact would have been glad to lend more money. Wehrung's conduct is to be judged by that of an ordinarily prudent and sagacious business man of his calibre, and we ask the court in considering this question to place itself in the position of such a sagacious business man and ask itself whether or not this and other circumstances do not clearly disclose the fact not only that Wehrung knew he was getting a preference, but that there was no time for dallying or for letting the transaction work out along the usual lines involving the usual delays.

* * * * *

In conclusion, we earnestly urge that if creditors generally are to have the assurance vouched for in in re Blount, 142 Fed. 263:

> "The main object of the Bankruptcy Act is to secure an equal distribution of the assets of an insolvent among all his creditors, and prevent preferences. And it is the duty of the courts to carry this principle into effect to the extent which the language of the act justifies. Schemes and artifices to evade the letter and spirit of the law will not be tolerated."

no such thin and transparent sequestration of assets of a designedly favored creditor can be permitted to stand. If the only solace for the creditors getting a 10 per cent dividend is the statement that in a proper case parity will be preserved but that the significant circumstances of this case were not sufficient to demand inquiry and explanation and create unfavorable inferences, then the words of Shakespeare are well applicable to the parity sections of the Bankruptcy Act:

> "And be these juggling fiends no more believed,
> That palter with us in a double sense;
> That keep the word of promise to our ear,
> And break it to our hope."

Respectfully submitted,

BEACH, SIMON & NELSON,

For Geo. M. Healy, Trustee, etc.

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